

Message Text

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DRAFTED BY: TREASURY: RJPATRICK, JR.

APPROVED BY: EB/IFD/OMA: RRYAN

L/T: WM MCQUADE (SUBS)

AF/E: GGAY

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FM SECSTATE WASHDC

TO AMEMBASSY NAIROBI

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E.O. 11652: N/A

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1. PLEASE ADVISE GOK THAT TREASURY HAS NO BASIC OBJECTION TO ACCEPTING

A BRANCH PROFITS TAX PROVISION OF THE TYPE PROPOSED BY GOK, PROVIDED THAT IN CONFORMITY WITH PREVIOUS UNITED STATES TAX TREATIES THAT RECOGNIZE A TREATY PARTNER'S RIGHT TO A BRANCH PROFITS TAX, U.S. GOVERNMENT RETAINS THE RECIPROCAL RIGHT TO IMPOSE A DIVIDEND WITHHOLDING TAX ON A FOREIGN CORPORATION THAT DISTRIBUTES A DIVIDEND WHERE SUCH CORPORATION RECEIVES MOST OF ITS EARNINGS FROM A BRANCH OPERATION CON-

DUCTED BY IT IN THE UNITED STATES. UNITED STATES INTERNAL LAW DOES NOT

PROVIDE FOR A BRANCH PROFITS TAX IN ADDITION TO BASIC CORPORATE TAX. IT DOES PROVIDE THAT WHERE A FOREIGN CORPORATION EARNS VIRTUALLY ALL OF ITS INCOME FROM SOURCES WITHIN THE UNITED STATES THERE IS A UNITED STATES WITHHOLDING TAX ON DIVIDENDS DISTRIBUTED BY THE FOREIGN CORPORA-

TION. IN OTHER WORDS, SUCH A FOREIGN CORPORATION IS ASSIMILATED TO A
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UNITED STATES CORPORATION FOR WITHHOLDING TAX PURPOSES. THE PRESENT

DRAFT TREATY DOES NOT PERMIT THE UNITED STATES TO IMPOSE THE WITHHOLD-
ING

TAX IN THIS SITUATION SINCE ARTICLE 6 PROVIDES THAT DIVIDENDS ARE FROM

UNITED STATES SOURCES ONLY IF DISTRIBUTED BY A UNITED STATES CORPORA-
TION AND OTHER ARTICLES LIMIT THE U.S. WITHHOLDING TAX ON DIVIDENDS TO

DIVIDENDS PAID FROM U.S. SOURCES. IN ALL TREATIES IN WHICH THE UNITE

STATES HAS RECOGNIZED THE RIGHT OF A FOREIGN GOVERNMENT TO IMPOSE AN
ADDITIONAL BRANCH PROFITS TAX, AS PROPOSED BY GOK, THE UNITED STATES
HAS THEN RESERVED THE RIGHT TO LEVY ITS WITHHOLDING TAX ON A FOREIGN
CORPORATION OPERATING PREDOMINATELY IN THE UNITED STATES ON THE THEORY

THAT THIS IS ANALOGOUS TO THE RIGHT OF THE FOREIGN COUNTRY TO IMPOSE
AN ADDITIONAL BRANCH PROFITS TAX. IN VIEW OF THIS PRECEDENT WE COULD
AGREE TO THE PROPOSED KENYA BRANCH PROFITS TAX PROVIDED THAT THE UNITED

STATES ALSO RETAINS THIS LIMITED WITHHOLDING TAX. WE DO NOT BELIEVE
THIS TO BE OF GENERAL PRACTICAL SIGNIFICANCE TO GOK SINCE IT ONLY
AFFECTS A KENYA CORPORATION CONDUCTING VIRTUALLY ALL OF ITS BUSINESS
IN THE UNITED STATES.

2. ADOPTION OF THIS AMENDMENT REQUIRES AMENDMENT TO THE SOURCE RULE AND

THE DIVIDEND ARTICLE OF THE EXISTING TREATY.

(A) PARAGRAPH ONE OF ARTICLE SIX (SOURCE OF INCOME) WOULD PROVIDE
AS FOLLOWS:

DIVIDENDS SHALL BE TREATED AS:

(A) INCOME FROM SOURCES WITHIN THE UNITED STATES ONLY IF --

(I) PAID BY A UNITED STATES CORPORATION OR

(II) PAID BY A CORPORATION OF ANY STATE IF, FOR THE 3-YEAR
PERIOD ENDING WITH THE CLOSE OF SUCH CORPORATION'S
TAXABLE YEAR PRECEDING THE DECLARATION OF THE
DIVIDENDS (OR FOR SUCH PART OF THAT PERIOD AS SUCH
CORPORATION HAS BEEN IN EXISTENCE) AT LEAST 80 PERCENT
OF SUCH CORPORATION'S GROSS INCOME FROM ALL SOURCES
WAS INDUSTRIAL OR COMMERCIAL PROFITS ATTRIBUTABLE TO
A PERMANENT ESTABLISHMENT WHICH SUCH CORPORATION HAD IN

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THE UNITED STATES.

(B) INCOME FROM SOURCES WITHIN KENYA ONLY IF PAID BY A CORPORA-
TION (OTHER THAN A UNITED STATES CORPORATION) RESIDENT IN
KENYA.

(B) PARAGRAPH (4) OF ARTICLE 12 SHOULD BE AMENDED BY ADDING THE
FOLLOWING TO THE END OF THE FIRST SENTENCE:

QUOTE: UNLESS SUCH DIVIDENDS ARE TREATED AS INCOME FROM SOURCES
WITHIN THAT OTHER CONTRACTING STATE UNDER PARAGRAPH (A)
KII) OF ARTICLE 6 (SOURCE OF INCOME). UNQUOTE.

(3) NEW PARAGRAPH TWO OF ARTICLE SEVEN SHOULD USE THE TERMS CONTRACT-

ING STATES AND CORPORATION TO CONFORM TO OTHER TREATY USAGE AS FOLLOWS:

(TO FOLLOW AS A NEW SENTENCE AFTER THE LAST WORD "RESIDENTS" IN
PARAGRAPH TWO OF ARTICLE SEVEN.)

QUOTE: PROVIDED THAT THIS PARAGRAPH SHALL NOT PREVENT ONE OF THE
CONTRACTING STATES FROM IMPOSING ON THE PROFITS ATTRIBUT-
ABLE TO A PERMANENT ESTABLISHMENT IN THAT CONTRACTING STATE

OF A CORPORATION WHICH IS A RESIDENT OF THE OTHER CONTRACT

-
ING STATE A TAX NOT EXCEEDING 7 AND A HALF PERCENT OF ITS
PROFITS IN ADDITION TO THE TAX WHICH WOULD BE CHARGEABLE
ON THOSE PROFITS IF THEY WERE THE PROFITS OF A CORPORATION
WHICH WAS A RESIDENT OF THE FIRST MENTIONED CONTRACTING
STATE. UNQUOTE.

(4) SIGNATURE WILL BE IN NAIROBI AND WE PROPOSE THAT ARTICLE 28 BE
COMPLETED TO PROVIDE FOR EXCHANGE OF INSTRUMENTS AT WASHINGTON AND
JANUARY 1, 1976 AS THE EFFECTIVE DATE.

(5) IF THESE PROPOSALS ARE ACCEPTABLE TO GOK, TREATY WILL BE PREPARED
IN THIS FORM FOR SIGNATURE. THIS REQUIRES FORMAL TRANSMITTAL FROM
TREASURY TO DEPARTMENT OF STATE AND OTHER PROCEDURAL FORMALITIES THAT
PRECLUDE COMPLETION BY END OF MONTH.

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